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The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

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A Strong Year For Housing . . .

Amid the array of mixed economic indicators released recently, one definite bright spot is the housing sector. Rising personal incomes, relatively stable home prices and mortgage interest rates near 10 percent have combined to lift the number of new single-family homes sold in the March-April period to a record 878,000 units at a seasonally adjusted annual rate. The previous two-month high was the May-June 1978 rate of 861,000 units. Not surprisingly, this rapid sales pace has led to a surge in new-home construction. The seasonally adjusted monthly average rate of housing starts during the January-April period of this year was an impressive two million units. This is the highest four-month average since late 1978, when mortgage interest rates were also around 10 percent.

The main force behind the strength in residential construction would seem to be lower mortgage interest rates. According to a nationwide survey conducted by the Federal Home Loan Bank Board, the average effective fixed mortgage interest rate (the original contract rate adjusted for initial fees and charges) in early April was about 10½ percent. This was the lowest mortgage interest rate in seven years. Further, the drop in fixed-rate mortgages has narrowed the gap between conventional fixed-rate mortgages and adjustable rate mortgages (ARMs). The latest figures show ARMs less than one percentage point below fixed rates. This is quite a change from the 2¼ percentage point spread that existed less than two years ago. Accordingly, the popularity of ARMs has faded, with their share of total loans down to 29 percent—the lowest rate since May 1983 and less than half the almost 70 percent share seen in August 1984.

. . . Supported By Improved Affordability . . .

In less than two years, mortgage interest rates have dropped about five percentage points, shaving about $250 per month off the average monthly mortgage payment on a 30-year mortgage for a median-priced new single-family home. What this translates into is greatly improved housing affordability. One measure of this, the housing affordability index, compiled by the National Association of Realtors, is at its highest level since 1979. Another estimate places the percent of households that can now afford to buy their first home at 40 percent—the highest figure since early 1979.

This surge in housing construction is expected to continue throughout 1986 with total housing starts for the year likely to reach 2.1 million units. One of the reasons for continued optimism about the strength of residential construction is that the supply of unsold new homes is very lean. At April's selling pace, the inventory of unsold new homes was only 4.7 months—the lowest level in almost 15 years and almost three months less than the recent peak in late 1984. This low an inventory level near the start of the traditional busy summer season should support a strong summer and fall for new-home construction, since builders can worry less about oversupply. What is more, mortgage interest rates may not have bottomed out yet, and when they do, they are not expected to rise rapidly in the near future.

An indicator of future construction, building permits were at their highest level in over two years in April. Most of the month's increase came in the single-family home category, with permits for this type of unit jumping more than nine percent, month-over-month. Permits for multi-family dwellings fell almost six percent during the same period. In the first four months of this year, single-family starts comprised 63 percent of total starts but accounted for almost 80 percent of the increase from the immediately preceding four-month period. Construction of multi-unit dwellings has been experiencing a slowdown in growth from 1985's strong showing due to less attractive depreciation schedules and other factors involved in the various tax reform plans.

Finally, consumer confidence is high. The University of Michigan's survey of consumer sentiment shows a record number of households with favorable attitudes towards buying homes over the past four months. And, according to the Conference Board's survey of consumer attitudes and buying plans, the number of households planning to buy a home in the next six months is the highest since 1978.

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. . . Bolsters Demand In Many Industries

The vigor in the housing industry is important to the economy in general because it affects so many other industries. It is particularly significant now because other sectors of the economy are still experiencing lackluster growth. The ripples from the housing boom benefit manufacturers of such construction materials as lumber, gypsum, roofing and glass. Homebuilding also aids those manufacturers who produce finished products, including major appliances, cabinets, and bathroom fixtures, to name a few.

What is more, these industries are also getting a boost from two other areas. First, there is an extremely strong resale market for existing homes. Existing single-family home sales topped 3.5 million units at a seasonally adjusted annual rate in April—the highest reading since late 1979. Second, spending on home improvement, after adjusting for inflation, is at a record level. In the first quarter of this year, consumers spent over $29 billion at a seasonally adjusted annual rate on additions and alterations to existing homes. Both these items translate into increased demand for many types of home furnishings, fixtures and construction materials.

For example, in April, 3.7 million major household appliances were shipped, establishing a new record

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since	
Reserve Bank Credit	6/4/86	Week Ago	Year Ago
U.S. Gov'ts and Agencies			
Owned Outright & RPs	190.114	+ 2.528	+16.470
Loans to Depository Inst.	.852	– .038	– 1.009
Float	.491	– .465	+ .347
Total Reserve Bank Credit	206.523	+ 2.097	+19.257
Treasury Deposits with Federal Reserve Banks	2.687	– .893	+ .287
Currency in Circulation	198.047	+ .863	+13.141
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	147.642	+ .574	+25.439
	6/4/86		
Member Bank Reserves:			
Total Reserves Held	47.870	+ .266	+ 7.240
Excess (Deficiency)	1.074	+ .346	+ .251
Net Free Reserves	.769	+ .297	+ .550
		% Change Since	
Monetary Aggregates †		Three Months Ago*	Year Ago
M1 (5/26/86)	660.5	+ 17.3‡	+ 13.0‡
M2 (April '86)	2,621.6	+ 8.2	+ 7.7
M3 (April '86)	3,288.8	+ 8.2	+ 7.8
Domestic Nonfinancial Debt (1st Q'86)	7,033.5	+ 8.7	+ 14.2

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 6/6/86	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.45%	6.47%	6.52%
* Federal Agencies	6.60	6.58	6.58
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.87	7.87	8.33
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.82	6.85	7.15

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.77%	Jul.	6.85%
15- 29 days	6.80	Aug.	6.80
30- 59 days	6.78	Sep.	6.80
60- 89 days	6.75	Oct.	6.80
90-179 days	6.70	Nov.	6.75
180-239 days	6.60	Dec.	6.70
240-270 days	6.55		

‡Industrial Paper—Prime			
30- 89 days	6.80%	†Federal Funds	
90-120 days	6.75	Effective Rate	6.85%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'86	$ 4,121	$ 4,059	$ 3,918
Gross National Product (1982 Dollars)*	1st Q'86	$ 3,624	$ 3,591	$ 3,548
Percent Change, Annual Rate	1st Q'86	3.7	0.7	3.7
Change in Consumer Prices*	Apr '86	– 3.6%	– 4.8%	3.6%
Change in Producer Prices*	Apr '86	– 7.2%	– 13.2%	6.0%
Civilian Employment (Thousands of Persons) †	May '86n	109,110	108,892	106,939
Unemployment as % of Civilian Labor Force †	May '86n	7.3%	7.1%	7.3%
Personal Income*	Apr '86	$ 3,447	$ 3,408r	$ 3,289
Leading Indicators Composite Index (1967=100)†	Apr '86n	179.2	176.6	166.7
Industrial Production Index (1977=100) †	Apr '86	125.1	124.9	124.1
Net Change in Consumer Installment Credit †	Apr '86n	$ 4.16	$ 3.09r	$ 7.54
U.S. Merchandise Trade Balance †	Apr '86n	–$ 12.07	–$ 12.18r	–$ 12.11
Plant and Equipment Expenditures*	2nd Q'86	$400.68(a)	$390.66(a)	$387.83
Private Housing Starts (Thousands of Units)*	Apr '86	2,009	1,930	1,851
New Construction Expenditures*	Apr '86n	$ 356.7	$ 353.9r	$ 341.9
Total Business Inventories †	Mar '86	$ 587.7	$ 585.2	$ 578.4
Total Business Sales †	Mar '86	$ 420.3	$ 427.2	$ 420.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

for the month, according to the Association of Home Appliance Manufacturers (AHAM). Year-to-date shipments are about two percent higher than the record level set in the same period in 1985. This pattern is likely to continue throughout 1986 for two main reasons. First, the AHAM estimates that each new home built needs an average of three new major appliances, so the expected pace of housing starts should translate into at least six million appliances. Second, there is a potential for significant replacement demand for appliances due to extremely strong purchases throughout the early 1970s. The Conference Board reports that the number of consumers planning to buy a new major appliance in the next six months has been running at a strong pace for several months.

A number of other industries are experiencing a pick-up in their shipments as well. Many companies that supply items used in new homes recently reported year-over-year shipment gains of between 10 and 30 percent for the first quarter of this year. And, not only are these primary suppliers enjoying improvement, but increased secondary spending connected with buying a new home, such as landscaping, lawyers' fees, title insurance, furniture and other items, is also filtering through the economy. One study by the National Association of Realtors suggests that each new-home sale generates about $90,000 in related economic activity. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (5/21/86)	155,729	– 249	– 504
New York City (5/28/86)	34,288	– 506	+ 961
Commercial Paper (5/28/86)	310,155	– 945	+50,099

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/21/86)	258,910	– 2,012	+ 3,095
New York City (5/28/86)	56,696	+ 58	– 4,723

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/21/86)	738,416	+ 4,605	+ 62,030
New York City (5/28/86)	159,349	– 1,227	+ 13,549

Financial Markets

	Friday 6/6/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.49%	+ .07	– .89
180-Day Bills†	6.66	+ .01	– .97
Longest Bills†	6.82	+ .02	– 1.17
Recent Issues:			
7 1/8s 5/31/88	7.28	– .02	
7 1/4s 3/31/90	7.70	–0–	
7 3/8s 5/15/96	7.99	– .04	
7 1/4s 5/15/16	7.70	– .01	
Municipals:			
Bond Buyer–20 Bond Index* (6/5/86)	7.97%	+ .27	– .63
Blue List Total ($ Million)	$2,128	+$ 19	+ $ 350
30-Day Visible Supply ($ Million)	$4,522	+$ 807	+ $1,002
Total	$6,650	+$ 826	+ $1,352
Corporates:			
Moody's Aa Composite (6/5/86)	9.56%	+ .05	– 1.87
30-Day Visible Supply ($ Million)	$4,345	+$1,480	+ $3,367
Stocks:			
Dow-Jones Averages:			
Industrials	1,885.90	+ 9.19	+ 556.26
Transportation	795.38	– 7.98	+ 135.55
Utilities	187.76	– 1.86	+ 23.93
65 Stocks	721.84	– .85	+ 173.74
N.Y.S.E. Composite Index	140.98	– 1.08	+ 31.01
N.Y.S.E. Avg. Daily Vol. for Week (000's)	114,934	–26,971	– 5,516

* 46% Taxable equivalent 14.76%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/6/86	Week Ago
Overnight	6.75%	6.69%
1 month	7.00	7.00
3 month	7.00	7.00
6 month	7.06	7.06
1 year	7.25	7.25
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	8.67%	8.15%
Long Term (7 to 15 yrs.)	9.05	8.50

FOREIGN EXCHANGE SPOT RATES New York Opening (6/6/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02194	45.58
Canada	.7162	1.3963
Denmark	.1214	8.2400
France	.1406	7.1125
Germany	.4477	2.2335
Italy	.0006538	1529.50
Japan	.005942	168.30
Mexico	.001646	607.50
Netherlands	.3979	2.5130
Switzerland	.5432	1.8408
U.K.	1.5050	.6645

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